CONSTRUCTION

	Housing Starts		Single Family Starts		Housing Permits		Construction Expenditures (Current)		Construction Expenditures (Real)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	1.686	1.643	1.238	1.208	1.586	1.598	397.3	397.1	348.2	349.1
May	1.598	1.606	1.115	1.130	1.487	1.493	398.6	394.3	349.6	345.9
June	1.552	1.597	1.067	1.096	1.469	1.517	394.0	392.4	345.0	342.7
July	1.588	1.611	1.103	1.159	1.503	1.488	391.9	391.8	342.0	339.9
August	1.611	1.611*	1.122	1.136*	1.516	1.505*	393.5	391.5*	341.9	338.1*
September	1.620	1.587	1.126	1.115	1.528	1.473	395.6	391.4	342.5	336.5
October	1.618	1.551	1.134	1.085	1.511	1.456	395.2	392.3	341.8	336.2
November	1.629	1.550	1.143	1.083	1.515	1.429	395.2	391.4	340.4	334.0
December	1.621	1.571	1.130	1.095	1.501	1.455	394.8	389.8	338.9	330.9
January 1988	1.583	1.605	1.108	1.126	1.492	1.489	396.9	390.6	339.8	329.9
February	1.560	1.603	1.083	1.120	1.467	1.506	399.0	392.8	340.7	330.4
March	1.552	1.579	1.086	1.092	1.473	1.501	401.3	395.7	341.5	331.1
April	1.588	1.558	1.115	1.085	1.489	1.467	401.9	396.7	341.2	330.9
May	1.609	1.565	1.139	1.093	1.521	1.465	403.4	396.1	341.6	329.3
June	1.608	1.574	1.130	1.098	1.518	1.473	404.9	396.7	341.7	328.4
July	1.589	1.588	1.116	1.105	1.493	1.479	409.4	397.8	344.3	328.2
August	1.595	1.574	1.102	1.082	1.498	1.483	412.0	399.5	345.3	328.3
September	1.592	1.568	1.104	1.076	1.492	1.480	414.1	400.7	346.2	328.2

	Non-Residential Construction		Public Construction		Residential Construction	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	121.4	121.3	76.7	76.3	199.2	199.5
May	123.8	126.6	75.8	74.6	198.9	193.1
June	123.0	121.7	76.1	72.2	194.9	198.3
July	122.3	120.4	77.0	73.2	192.6	198.2
August	122.0	119.6*	77.8	74.0*	193.7	197.9*
September	122.0	119.0	78.7	74.6	194.9	197.8
October	121.7	119.5	78.0	75.3	195.5	197.5
November	121.4	119.1	77.6	75.8	196.0	196.5
December	121.1	118.4	77.5	75.9	196.2	195.5
January 1988	121.4	118.3	78.8	76.5	196.7	195.8
February	121.6	118.5	80.1	77.1	197.3	197.2
March	121.9	118.8	81.5	77.6	197.9	199.3
April	122.5	119.4	80.7	78.1	198.7	199.2
May	122.8	119.7	81.1	78.5	199.5	197.9
June	123.2	120.0	81.5	79.0	200.2	197.7
July	123.8	120.3	81.9	79.4	203.7	198.1
August	124.4	120.0	82.1	79.9	205.5	199.6
September	125.1	120.2	82.4	80.4	206.6	200.1

Fore. = August Forecast
C.E. = Current Expectations
* = This item and those beyond it are projections.

BUSINESS ACTIVITY

	Manufacturers' Inventories		Durable Goods Orders		Non-Defense Capital Goods Orders		Non-Defense Capital Shipments	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	320.8	320.8	106.93	106.98	28.30	28.31	27.33	27.32
May	321.5	321.8	106.98	106.99	29.99	30.03	26.95	26.97
June	321.4	321.6	108.53	109.18	29.09	29.99	27.61	27.85
July	321.9	323.0	109.24	108.51	29.93	31.52	27.53	28.08
August	322.5	324.2*	107.65	107.59*	28.65	29.87*	27.65	28.23*
September	322.9	325.1	105.46	107.26	27.84	29.42	27.79	28.35
October	323.6	325.8	105.93	107.45	27.95	29.63	27.85	28.51
November	324.3	326.5	106.81	108.11	28.13	29.69	27.96	28.60
December	324.8	327.4	107.16	108.82	28.42	29.84	28.33	28.89
January 1988	325.3	328.0	107.03	106.76	28.06	28.17	27.46	27.96
February	326.0	328.9	107.42	107.16	28.31	28.29	27.83	28.25
March	326.9	329.8	107.95	107.85	28.59	28.53	28.21	28.43
April	328.1	330.6	106.64	107.92	28.47	28.50	28.25	28.40
May	329.0	331.5	106.93	107.27	28.53	28.46	28.33	28.67
June	329.3	332.3	107.72	107.65	28.69	28.55	28.24	28.62
July	330.0	333.1	107.59	109.43	28.75	29.11	28.43	28.75
August	331.4	333.8	108.86	109.96	28.89	29.38	28.55	28.81
September	331.8	334.7	109.43	109.47	29.06	29.30	28.72	28.80

	Business Inventories		Defense Shipments		Industrial Production		Capacity Utilization	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	665.9	665.9	8.76	8.76	127.3	127.4	79.4	79.5
May	670.4	671.6	9.23	9.24	128.0	128.3	79.7	79.9
June	669.2	674.2	9.36	9.44	128.2	128.8	79.7	80.1
July	673.4	677.5*	9.45	8.87	128.7	129.8	79.9	80.5
August	677.5	679.2	9.36	9.24*	129.0	130.3*	80.0	80.7*
September	678.1	680.6	9.40	9.33	129.3	130.6	80.0	80.8
October	682.5	682.4	9.46	9.30	129.6	130.8	80.1	80.8
November	685.3	684.3	9.55	9.42	129.8	131.1	80.1	80.9
December	687.4	686.9	9.63	9.48	130.1	131.3	80.1	80.9
January 1988	691.5	690.4	9.69	9.55	130.4	131.6	80.1	80.9
February	694.3	693.3	9.76	9.62	130.9	131.9	80.3	81.0
March	696.1	696.2	9.77	9.56	131.3	132.2	80.4	81.0
April	699.2	698.9	9.83	9.64	131.6	132.5	80.4	81.0
May	702.5	701.8	9.89	9.70	132.0	132.8	80.5	81.1
June	704.6	704.5	9.95	9.76	132.4	133.1	80.6	81.1
July	707.8	707.2	10.03	9.93	132.8	133.5	80.7	81.2
August	709.6	709.7	10.09	9.78	133.2	133.8	80.9	81.3
September	712.9	712.6	10.15	9.96	133.6	134.0	81.0	81.3

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PRICES

	CPI-U (seasonally adjusted)		PPI Finished Goods (seasonally adjusted)		PPI-Industrial Commodities (unadjusted)		Estimated GNP Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	337.9	337.9	295.3	295.3	317.4	317.4	116.9	116.8
May	339.0	339.0	296.2	296.2	318.6	318.6	117.2	117.2
June	340.4	340.4	296.8	296.8	320.2	320.2	117.6	117.6
July	341.2	341.1	296.7	297.4	321.8	322.6	118.0	118.0
August	342.5	342.0*	297.3	297.3*	322.6	323.2*	118.4	118.2*
September	343.8	343.3	298.0	298.0	321.0	321.4	118.8	118.6
October	344.6	344.9	298.5	298.8	323.1	323.5	119.0	119.2
November	345.5	345.7	299.1	299.3	323.6	323.9	119.3	119.6
December	346.4	346.5	299.5	299.9	324.2	324.8	119.6	120.0
January 1988	347.6	347.3	300.1	300.6	325.8	325.7	120.0	120.4
February	348.7	348.6	300.6	301.3	327.6	327.2	120.5	120.7
March	349.9	349.9	301.2	302.2	329.3	328.5	120.9	121.2
April	351.4	351.3	302.5	303.2	330.5	329.7	121.3	121.5
May	353.0	352.6	303.8	304.3	331.0	331.0	121.7	121.9
June	354.6	354.0	304.1	305.0	331.5	331.8	122.1	122.4
July	356.0	355.5	305.5	306.1	333.9	332.9	122.5	122.9
August	357.1	356.9	305.8	306.9	335.0	334.2	123.0	123.4
September	358.3	358.3	306.3	307.8	333.7	335.5	123.4	123.9

	Consumption Deflator		Consumer Durables		Consumer Nondurables		Consumer Services		Implicit Construction Deflator	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	117.7	117.9	106.0	105.9	111.1	111.2	126.2	126.5	113.8	113.8
May	118.3	118.5	105.9	105.9	111.8	111.8	126.8	127.2	114.0	114.0
June	118.8	118.9	106.2	106.5	112.4	112.3	127.3	127.4	114.2	114.5
July	119.3	119.2*	106.6	106.7*	112.8	112.7*	127.8	127.7*	114.6	115.3
August	119.7	119.3	107.0	106.5	113.2	113.1	128.2	128.1	115.1	115.8*
September	120.0	119.7	107.3	106.8	113.5	113.4	128.6	128.5	115.5	116.3
October	120.4	120.4	107.3	107.1	113.8	113.8	129.0	129.0	115.8	116.7
November	120.7	120.7	107.4	107.4	114.1	114.1	129.5	129.4	116.1	117.2
December	121.0	121.1	107.5	107.6	114.4	114.5	130.0	129.9	116.5	117.8
January 1988	121.5	121.4	107.8	107.8	114.8	114.9	130.5	130.3	116.8	118.4
February	121.9	121.8	108.0	108.0	115.1	115.2	131.0	130.7	117.1	118.9
March	122.4	122.2	108.2	108.3	115.4	115.6	131.5	131.2	117.5	119.5
April	122.9	122.6	108.5	108.5	115.9	116.0	132.0	131.6	117.8	119.9
May	123.3	123.0	108.8	108.8	116.4	116.3	132.6	132.1	118.1	120.3
June	123.7	123.5	109.1	109.0	116.8	116.8	133.2	132.6	118.5	120.8
July	124.2	124.0	109.4	109.3	117.3	117.2	133.8	133.2	118.9	121.2
August	124.7	124.5	109.6	109.5	117.8	117.7	134.3	133.8	119.3	121.7
September	125.1	125.0	109.9	109.8	118.2	118.1	134.7	134.4	119.6	122.1

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MISCELLANEOUS

	Merchandise Trade Balance		Leading Indicators		Estimated GNP		Estimated GNP (1982 $)		IVA (annual rate)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore	C.E.
April 1987	-13.32	-13.32	186.6	187.9	4420	4414	3781	3779	-15.9	-9.7
May	-14.40	-14.04	187.5	188.9	4452	4454	3799	3800	-20.3	-11.6
June	-14.00	-15.71	188.0	190.8	4474	4475	3804	3805	-22.9	-12.3
July	-14.63	-15.87p	188.6	191.8	4502	4505	3815	3818	-16.3	-10.5
August	-14.27	-14.86*	188.9	192.2*	4524	4528*	3821	3831*	-10.5	-7.3*
September	-13.60	-14.55	189.4	191.7	4546	4550	3827	3836	-7.4	-5.4
October	-12.96	-13.29	189.0	192.0	4563	4573	3834	3836	-9.5	-6.6
November	-13.55	-14.42	188.6	192.4	4575	4596	3835	3843	-13.4	-8.9
December	-13.73	-14.57	189.1	192.8	4594	4633	3841	3861	-15.5	-11.5
January 1988	-13.26	-14.26	188.7	191.6	4622	4656	3852	3867	-16.2	-10.2
February	-12.43	-13.53	188.2	192.1	4657	4682	3865	3879	-17.1	-11.5
March	-11.86	-13.05	187.8	192.5	4680	4711	3871	3887	-17.1	-11.8
April	-12.24	-13.16	187.2	192.2	4701	4735	3876	3897	-16.3	-12.5
May	-12.85	-13.52	188.0	192.0	4735	4761	3891	3906	-15.4	-12.1
June	-12.76	-13.81	188.3	192.3	4771	4794	3907	3917	-14.5	-12.4
July	-13.56	-13.96	188.9	192.9	4795	4818	3914	3920	-13.9	-13.1
August	-13.02	-13.65	189.2	193.3	4816	4843	3915	3925	-13.2	-13.8
September	-11.90	-12.47	189.3	193.0	4838	4874	3921	3934	-13.5	-13.5

Fore. = August Forecast
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* = This item and those beyond it are projections.

FINANCIAL MARKETS

	Monetary Base		M1		M2		Federal Funds		T-Bills (6 Mos.)	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	262.2	262.2	750.4	750.3	2839.1	2837.9	6.37	6.37	5.90	5.90
May	263.4	263.4	753.2	753.1	2840.1	2838.7	6.85	6.85	6.05	6.05
June	263.8	263.4	746.7	746.6	2842.8	2840.3	6.73	6.73	5.99	5.99
July	264.4	264.3	748.5	747.6	2854.3	2846.0	6.56	6.58	5.88	5.76
August	265.5	266.3*	750.6	751.9*	2868.1	2859.6*	6.65	6.72*	5.80	6.13*
September	266.7	267.5	752.9	755.7	2881.8	2874.1	6.68	6.96	5.83	6.29
October	268.9	268.8	758.4	758.0	2898.3	2885.6	6.73	7.05	5.86	6.43
November	270.8	269.6	763.1	760.8	2913.6	2899.2	6.70	6.93	5.93	6.40
December	272.6	270.9	767.9	765.3	2925.7	2916.3	6.59	6.95	6.02	6.42
January 1988	274.5	272.4	773.5	770.6	2948.2	2936.5	6.43	7.06	5.79	6.55
February	276.4	274.3	779.4	776.5	2967.5	2954.9	6.34	7.13	5.70	6.62
March	278.3	276.5	785.5	783.3	2986.6	2978.8	6.25	7.12	5.65	6.65
April	280.0	278.0	790.3	786.7	3003.5	2991.7	6.38	6.98	5.88	6.58
May	281.7	279.8	796.1	789.0	3020.2	3003.7	6.69	6.93	6.01	6.53
June	283.4	281.4	801.8	794.1	3036.9	3023.1	6.94	7.02	6.13	6.59
July	285.1	283.3	805.2	800.3	3054.5	3043.7	6.73	7.16	6.08	6.69
August	286.8	285.1	809.1	805.7	3072.4	3064.2	6.56	7.26	5.93	6.84
September	288.5	287.0	813.0	811.9	3090.1	3084.7	6.57	7.34	5.80	6.89

	Aaa (Seasoned)		Municipals (Bond Buyer)		(3 Month) Commercial Paper		90 Day CD's		Prime Rate	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	8.85	8.85	7.55	7.55	6.45	6.45	6.52	6.52	7.75	7.75
May	9.33	9.33	8.00	8.00	6.93	6.93	6.99	6.99	8.14	8.14
June	9.32	9.32	7.79	7.79	6.92	6.92	6.94	6.94	8.25	8.25
July	9.42	9.42	7.68	7.72	6.67	6.65	6.75	6.70	8.25	8.25
August	9.50	9.63*	7.74	7.80*	6.65	6.67*	6.73	6.73*	8.25	8.25*
September	9.50	10.06	7.70	7.94	6.73	6.93	6.84	7.00	8.25	8.72
October	9.59	10.23	7.82	8.08	6.78	7.02	6.89	7.08	8.25	8.75
November	9.57	10.02	7.77	7.92	6.75	6.95	6.83	7.05	8.25	8.75
December	9.54	10.07	7.73	7.97	6.55	6.92	6.67	7.01	8.25	8.75
January 1988	9.33	10.18	7.52	8.08	6.40	7.02	6.53	7.13	8.25	8.75
February	9.18	10.05	7.34	7.95	6.26	7.18	6.39	7.22	8.25	8.75
March	9.21	10.02	7.37	7.92	6.25	7.15	6.35	7.24	8.25	8.75
April	9.37	10.12	7.54	7.94	6.41	7.04	6.52	7.15	8.25	8.75
May	9.48	10.15	7.64	8.06	6.68	6.92	6.79	7.04	8.25	8.75
June	9.59	10.20	7.75	8.11	6.95	7.01	7.06	7.09	8.25	8.75
July	9.33	10.34	7.48	8.27	6.76	7.26	6.89	7.34	8.25	8.75
August	9.21	10.59	7.37	8.53	6.53	7.42	6.65	7.51	8.25	8.92
September	9.09	10.68	7.24	8.63	6.50	7.51	6.63	7.60	8.25	9.00

Fore. = August Forecast
C.E. = Current Expectations
* = This item and those beyond it are projections.

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Economic Forecasting Center
College of Business Administration
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MONTHLY PROJECTIONS
September 1987

Dr. Donald Ratajczak, Director
For Release: September 25, 1987

THE LAST PHASE OF THIS EXPANSION

This unusually long economic expansion has been aided by the 1986 collapse in oil prices and an earlier premature tightening move by the Federal Reserve in 1984. The 1984 Federal Reserve action caused an unusually overvalued dollar that sapped the strength of industrial America at a time when consumers still were willing and able to pursue a buying binge. When consumer debt had risen to levels that normally create restraint, the 1986 oil price collapse put even more purchasing power in their pockets. At the same time, an overvalued dollar caused manufacturing to increase efficiencies and maintain tight controls on production relative to sales. Only the automobile industry showed any deviation from good production and sales coordination. With consumption continuing to expand but with industrial activity corralled by foreign competition, a slow growth economy showed no prospects of readily creating industrial bottlenecks or exhausting the available pool of skilled workers.

Skilled workers still are plentiful, although the insured unemployment rate has now reached a low for this cycle at 2.2% in the week of September 5. Some studies suggest that an insured unemployment rate approaching 1.5% is consistent with full employment for the national economy. Thus, the pool of available experienced workers is shrinking but should not hit those full employment limits in the next few months.

On the other hand, labor force growth has slowed sharply even as economic activity appears to be intensifying. Teenage participation rates remain stuck at 56% while the teenage population slowly drifts downward. Participation rates for males over twenty also appears to be stuck at 78% despite falling unemployment rates. Only the participation rates of females are rising, and their rate of increase appears to be only half as rapid as earlier in the decade. Because of these changes in labor force activity, this year's labor force is growing 0.3 percentage points more slowly than last year despite significant gains in employment opportunities. Indeed, excluding the effects of

changing unemployment upon labor force participation, the full employment labor force probably is growing only 1.5% per year.

This slower labor force growth would reduce unemployment even if economic activity continued to grow at subdued rates. However, industrial activity is spurting forward at a 4% annual rate, as measured by the industrial production index. Total economic activity may be growing at a 3.5% annual rate. With productivity improving less than 1% for the overall economy, and the workweek near cyclical highs, the unemployment rate is now plunging at nearly a percentage point per year. As a result, some of the low unemployment regions of the country along the Altantic Ocean are experiencing difficulties in attracting entry-level workers. Wages are beginning to intensify, especially in the service industries.

This pattern of tightening labor markets and increasing wage pressures has been experienced many times before, in the final phases of an economic expansi Normally, labor shortages are more closely aligned with capacity problems and he effects of increasing activity upon economic costs are more abrupt than currently being observed. Indeed, the hourly earnings index remains only 2.6% above previous year levels, although the August report showed a spurt of 4.8% at annual rates. The index measuring delivery delays is only 62 as opposed to a rating in the 70s prior to most economic peaks. However, that index has risen by a full 10 percentage points in the past three months. Also, while capacity utilization remains a relatively low 81%, utilization rates exceed 97% for the textile and paper industries and are also above 90% for rubber and plastics. In addition, utilization rates in the metals-producing industries have increased by more than 7 percentage points in a year. While ample excess capacity remains, this capacity is not available at a moments notice. Furnaces need to be lined and primed before metal production can begin. As a result, demand must appear to be strong for months into the future before additional capacity will be utilized. In short, the developing cost pressures associated with accelerating economic growth shows all the signs of the last stage of an economic expansion.

Economic activity can expand briskly for a period of time near the end of the expansion. This occurs as increased delivery delays intensify the demand for inventories. As a result, orders spurt upward for a period of time, hirings increase, the unemployment rate moves toward inflation-prone levels and economic activity can accelerate. However, also occurring are rising wage pressures, higher interest rates, especially short-term rates, and intensifying inflationary pressures. Some of the inflation may be experienced in commodities, but as wage pressures intensify, a significant amount of the inflationary pressures begin to spill over into services. That is exactly the pattern that appears to be developing, if in modified form.

Indeed, wages increased sufficiently in August to cause a 0.9% increase in real earnings despite a 0.5% gain in the CPI. Some of these wage gains were the result of composition changes, but hourly labor costs definitely are intensifying. Short-term interest rates are rising with commercial paper rates consistently above the federal funds rate. This normally is a signal of increasing borrowing pressures for inventory investing purposes. Service inflation, which had been well-contained through the first half of 1987, is beginning to intensify. There will be one more period of moderate inflation when oil prices decline late this year. As a result, this ending phase of the cycle will be elongated slightly, and may propel increasing economic activity through 1988.

Because economic friction begins increasing near the end of an economic upturn, interest rates also tend to rise along with inflation. Stock prices eventually will decline. However, both revenues and costs tend to rise. To the extent that revenues increase first, earnings may perform better than anticipated for a period of time. As a result, equity values could continue to rise. However, increased interest costs and rising wage cost pressures eventually will overcome the growth in revenues. Ultimately, earnings decline and equity values fall. When that occurs, the economy normally will be approaching a cyclical peak.

At the present time, the stock market is being buffeted between higher interest rates and favorable earnings performances. Because of reductions in marginal tax rates, corporate earnings in the third and fourth quarters should compare especially favorably with the previous year. For that reason, the stock market may not peak until the end of this year. However, downward pressures upon earnings could begin as early as the beginning of 1988. By that time, this unusually long bull market should come to an end.

Quarterly Profile of GNP

	1987-2	1987-3	1987-4	1988-1	1988-2	1988-3	1987 Annual	1988 Annual
Real:	2.5	3.7	2.5	2.9	2.4	2.2	2.7	2.7
Price:	3.5	3.2	4.4	4.1	4.1	4.6	3.1	4.1
Nominal:	6.3	6.9	7.0	7.1	6.7	6.9	5.9	6.9

Monthly Statistical Highlights for September 1987

Payroll employment +237,000; index of hours worked +0.3%; household employment +350,000; civilian unemployment rate 6.0%; personal income +0.5%; savings rate 2.0%; personal consumption +0.3%; retail sales +0.3%; auto sales 11.2 million units; housing starts -0.9%; housing permits -2.2%; construction expenditures UNC; business inventories +0.1%; orders for durable goods +1.1%; orders for nondefense capital goods +0.5%; industrial production +0.3%; CPI +0.4%; PPI +0.4%; consumption deflator +0.3%; leading indicator -0.3%; real GNP (AR) +2.9%; M1 (AR) +2.9%; M2 (AR) +4.4%.

Monthly Statistical Highlights for October 1987

Payroll employment +267,000; index of hours worked +0.3%; household employment +208,000; civilian unemployment rate 6.0%; personal income +0.6%; savings rate 3.2%; personal consumption -0.6%; retail sales -2.6%; auto sales 8.9 million units; housing starts -1.5%; housing permits -1.8%; construction expenditures +0.1%; business inventories +0.4%; orders for durable goods +0.8%; orders for nondefense capital goods +0.9%; industrial production +0.2%; CPI +0.3%; PPI +0.3%; consumption deflator +0.5%; leading indicator -0.3%, real GNP (AR) +0.9%; M1 (AR) +10.5%; M2 (AR) +7.4%.

Commentary

Employment - In the week ending September 12 insured unemployment plunged by 57,000 to a cyclical low of 260,000. A week earlier, the insured unemployment rate fell to 2.2%, also the lowest of this cycle. This data may be distorted by Labor Day seasonal problems, but the dimensions of the decline suggest that employment activity is more robust early in September than had been anticipated. No adjustments have yet been made to our projections to suggest more substantial economic activity, however.

Clearly, the speed by which insured unemployment is declining suggests that increasing wage pressures could develop soon after 1988 begins. The Ford-UAW contract already appears to add 20% to labor costs in the next three years, assuming a 5% rate of inflation. Such an increase, if practiced nationwide, would definitely add to inflation.

Personal Income and Outlays - Wage and salary earnings grew 0.9% in August, as anticipated; but farm income took an unexpected decline. Apparently, subsidy programs diminished sharply during the summer. Further modest decreases in farm incomes are expected in September. Because September tax liabilities coincide with estimated tax payments, a surge in those liabilities is anticipated. As a result, disposable income probably will increase by less than 0.5%.

Although automobile sales are slowing from their August surge, sales will remain relatively robust. Also, unusually hot weather that lasted through August and pushed up service expenditures, now is moderating. Therefore, service expenditures should show very minimal gains at that time. In addition, expenditures for durable goods reflected the magnitude of automobile unit sales in August, although the preliminary retail sales report sharply understated growth in auto revenues. As a result, retail sales probably will be revised upward significantly for August when the September data are announced. Because unit auto sales are declining in September, expenditures for durables should fall.

Following strong gains in July, sales of hardware and furniture fell significantly in August. As a result, sales of nonauto durable goods probably will grow much more slowly than originally anticipated.

Construction - Rising mortgage rates are beginning to effect housing starts. Single-family starts fell significantly in August, although housing permits suggest that a slight rebound is possibile in September. Multi-family permits fell while multi-family starts rose in August. However, further weakness is expected for multiple units. Because mortgage rates are expected to approach 12% by the summer of 1988, single-family starts are expected to fall about 100,000 short of forecasted values. This means that housing starts will average slightly less than 1.5 million for 1988. Because of an acceleration in housing prices, residential construction expenditures are growing more rapidly than anticipated in our forecast. However, as starts begin declining significantly, construction expenditures will dip substantially below forecasted values. On the other hand, only a modest further decline in construction expenditures is anticipated.

Business Activity - Orders for nondefense capital goods fell sharply in August after climbing heights that had previously not been anticipated. As unfilled

orders continue to increase, this decline in capital goods orders is not serious. Indeed, capital shipments should continue to rise significantly, except for the year-end distortions that momentarily accelerate shipments late in the year and then cause weakness early in the subsequent year.

On the other hand, defense shipments are surprisingly weak and defense orders are continuing to slow. Even here, the backlog has not diminished, but it is not growing either. As a result, the growth in defense shipments is expected to be much more modest than originally expected. This is the result of previously enacted budgetary restraints. Although the August pause in durable goods orders is no cause for alarm, any further declines in orders during September could be viewed with some concern.

Business inventories were surprisingly brisk in July considering significant slowing in the growth of automobile inventories. Auto incentives should cause auto inventories to fall significantly in August and September. However, manufacturing inventories are expected to continue growing, but not at the substantial rate of July.

Although industrial production slowed to only a 0.3% rate of increase in August, the report was generally strong. Activity in plant and equipment increased by a full percentage point. While consumer goods production only increased 0.2%, this overcame a drop in auto assemblies from 6.7 million units to only 5.9 million units. Obviously, a rebound should be anticipated in the months ahead barring any auto strike. Certainly, moderate increases in industrial production appear likely in the next few months. In fact, a significant decline in initial unemployment claims may suggest that industrial activity is expanding more rapidly in September than currently projected.

Because of unusually low additions to capital at the present time, this moderate increase in industrial activity is leading to a significant increase in capacity utilization. By the middle of 1988, the utilization rates will exceed the highs previously reached for this cycle in 1984. When utilization rates cross 82%, orders normally are stimulated, unless the credit markets or financial conditions significantly dissuade investors.

Prices - Although the 0.5% increase in the consumer price index for August was a surprise, much of the higher performance than anticipated was the result of rising rental rates. Following a 0.6% increase in rents in July, which we assumed was the result of a new fiscal year, rents rose another 0.8% in August. Although the August increase probably will not be sustained in the next few months, reduced vacancy rates along with the absence of tax incentives for constructing apartment units is beginning to exert upward pressures upon rental rates. For the remainder of this year and well into next year, rents are expected to grow at a 6% annual rate. Previously, they were expanding at a 4% annual rate. Also, while many economists have argued that the August 0.5% increase is an abberation, several unsustainable pricing events kept that increase from being even higher. Auto financing incentives were introduced in August this year, while the seasonals were anticipating incentives a month from now. Light truck incentives will arrive in September. The auto industry wants to establish a 4% price increase for new model cars. Thus, the automobile and auto financing component will be adding to inflationary pressures in September and October. Also, grocery store prices fell in August. Our PPI estimates for September show that they will be up about a half percent. To be sure, gasoline prices, which surged 3.1% in August will show no growth in September. However,

it is clear that inflation is now running closer to 5% with the acceleration of some of the service components than to the 4% level that many economists thought would re-appear after oil prices stabilized.

Price increases for the producer price index in September reflect fewer additional auto incentives than normal because incentives for passenger cars began a month early. Also, unseasonal increases in food prices and continuing widespread increases in the metals prices are adding to price pressures. The chemicals, paper, and metals industries all have announced significant price increases for early October. Fortunately, crude material prices are no longer rebounding as dramatically as earlier in the year. Nevertheless, these price surges will continue to put upward pressures upon commodity inflation into the early months of 1988. It is simply inappropriate for Alan Greenspan to declare that no signs of inflationary pressures exist at the present time.

Miscellaneous - Stock prices continued to rise in August. In addition, sensitive prices may have added slightly to the leading indicators. Delivery delays appear to be as intense in August as they were in July. Furthermore, insured unemployment claims are now falling significantly. By September, however, stock prices may subtract from the leading indicators. In addition, sensitive prices almost certainly will be reversing contributions from positive to negative. Therefore, a temporary lull in growth of the leading indicators is anticipated.

On the other hand, the merchandise trade balance in August should improve considerably from the record deficit in July. Seasonal factors will be aiding manufacturing exports. Also, significant exports of American grains occurred in recent weeks. On the other hand, oil imports appear to be slowing following their July surge. Thus, the merchandise trade balance should improve by nearly $2 billion from the previous month.

FINANCIAL MARKETS

As economic activity continues to surge during the summer months, interest rate pressures continue to intensify. Loan activity does not show the magnitude of interest rate as many corporations are self-financing their inventory expansion. However, this diminishes the responsiveness of corporate treasurers to bank sales of short-term certificates. This explains why interest rates for C.D.s are rising sharply early in September.

The one good news in the interest rate profile is the reduction in government deficits. It now appears that the 1987 deficit was under $160 billion. Of course, some of that improvement was the result of one-time payments for large capital gains transactions. Some increase in the deficit should be anticipated for the next fiscal year. However, Congress has now passed a Gramm-Rudman target requiring $23 billion in deficit reductions. If such a reduction is not achieved, across-the-board expenditures cuts shared by defense and social programs will be initiated. As a result, deficits may continue to decline the next fiscal year.

Next year, interest rate prospects depend heavily upon the sentiments of foreign investors. If those investors are reluctant to acquire American assets, as we assume, the dollar will fall in value while foreign investors will demand higher interest rates in order to acquire American debt instruments. The yen

may appreciate to 125 to the dollar and the Deutsch mark may strengthen to 1.65 marks to the dollar in the early months of 1988. Of course, once the dollar reaches a low point from which only increases can be anticipated, foreign investors will become much more willing to purchase American bonds. For that reason, interest rates are not expected to increase dramatically next year.

Equity Markets - Many equity investors are looking for signs of the last surge in investing activity that normally dictates the top of a bull market. This surge typically is represented by a significant broadening of price increases and a significant increase in small investor activity. However, the equity markets may not show that pattern during this cycle. Just as institutional changes have altered the relationship between the money stock and economic activity, behavioral changes have altered the responsiveness of the equity markets to investment by small holders. While some analysts are waiting for the small investor to enter the market, sales of mutual funds suggest that the small investor has aggressively been a part of this market for more than a year. However, instead of making their own stock selections, these investors have entrusted their funds to the professionals that run mutual funds. As a result, the small investor's money is being invested through professional management eyes. These professional managers have no inclination to go toward less popular securities. As a result, the equity markets probably will not broaden their base or rally sharply before turning down.

Although Robert Prechter still maintains that one last wave of speculative surge will occur before this market ends its up trend, he is somewhat disturbed by the obvious bear market in bonds. Can investors really be so enthusiastic in buying equities when they obviously are depressed when they think of bonds? To be sure, equity markets can continue to move upward long after bond markets have reversed direction. However, the longest that a discrepancy between the two markets appears to have developed was in 1928 and 1929, when the bond market collapse predated equity markets by eighteen months. If the bond market is assumed to have peaked in April 1986, when the lowest yields on long-term treasury securities were attained, then the eighteen month discrepancy between the bond and stock market will have been achieved by this November. On the other hand, if the bear market in bonds is dated only from this April, then a discrepancy between the two markets could be historically supported until the latter half of 1988.

Given our analysis that the economic cycle is in its last up phase, the stock market probably will peak by the beginning of 1988. At that time, rising finance costs and higher wage pressures will begin to erode the earnings that currently are being enhanced by inflationary pressures. With both earnings and interest rates signalling lower stock prices, it would be very difficult indeed for the market to continue rising. Thus, the peak in the equity markets is not far away. For those who are becoming nervous, liquidations of stock positions at this time will not deprive investors of significant appreciation opportunities.

EMPLOYMENT

	Payroll Employment		Index of Hours Worked		Household Civilian Employment		Civilian Unemployment Rate		Hourly Earnings Index	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	101598	101598	119.6	119.6	111835	111835	6.3	6.3	172.6	172.6
May	101672	101708	120.2	120.2	112447	112447	6.3	6.3	172.7	172.9
June	101788	101818	120.1	120.0	112257	112257	6.1	6.1	173.1	172.9
July	101973	102114	120.4	120.6	112462	112727	6.2	6.0	173.5	173.2
August	102150	102270	120.6	121.2	112653	113081	6.1	6.0	173.9	173.9
September	102327	102507*	120.9	121.6*	113171	113431*	6.2	6.0*	174.5	174.3*
October	102485	102774	120.9	121.9	113029	113639	6.3	6.0	174.7	174.7
November	102628	102951	121.0	122.1	113292	113855	6.3	5.9	175.0	175.1
December	102771	103137	121.2	122.3	113556	114070	6.2	5.9	175.2	175.5
January 1988	102965	103408	121.4	122.6	113769	114389	6.2	5.7	175.8	175.9
February	103163	103594	121.7	122.8	113970	114561	6.2	5.8	176.6	176.3
March	103360	103780	122.1	123.0	114173	114788	6.1	5.7	177.4	176.8
April	103526	103966	122.2	123.2	114388	115009	6.2	5.7	177.8	177.3
May	103693	104184	122.4	123.5	114595	115268	6.2	5.6	178.3	177.9
June	103860	104371	122.5	123.7	114804	115479	6.1	5.6	178.9	178.5
July	104051	104557	122.7	123.9	114992	115719	6.1	5.5	179.5	179.1
August	104225	104743	123.0	124.1	115134	115865	6.0	5.5	180.1	179.9
September	104400	104837	123.3	124.2	115276	116058	6.1	5.5	180.7	180.5

PERSONAL INCOME

	Personal Income		Wage & Salary		Personal Savings		Disposable Income		Personal Outlays	
	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.	Fore.	C.E.
April 1987	3.700	3.704	2.182	2.182	32.9	42.3	3.067	3.070	3.034	3.028
May	3.718	3.713	2.193	2.194	146.4	136.7	3.176	3.171	3.030	3.035
June	3.731	3.715	2.201	2.199	122.3	101.1	3.173	3.157	3.050	3.056
July	3.749	3.732	2.211	2.208	122.8	92.6	3.190	3.171	3.067	3.078
August	3.765	3.750	2.220	2.227	119.5	58.6	3.204	3.182	3.085	3.123
September	3.782	3.770*	2.228	2.240*	99.3	64.9*	3.220	3.197*	3.121	3.132*
October	3.795	3.791	2.236	2.253	111.2	101.7	3.229	3.215	3.118	3.113
November	3.809	3.808	2.244	2.263	105.0	97.0	3.238	3.228	3.131	3.131
December	3.825	3.826	2.252	2.274	100.8	88.0	3.249	3.241	3.148	3.153
January 1988	3.834	3.839	2.265	2.286	128.7	111.9	3.296	3.290	3.167	3.178
February	3.855	3.857	2.277	2.297	124.9	109.4	3.308	3.310	3.181	3.201
March	3.886	3.876	2.290	2.308	111.7	108.4	3.315	3.327	3.203	3.219
April	3.907	3.897	2.301	2.320	117.3	128.0	3.336	3.344	3.219	3.216
May	3.919	3.920	2.313	2.335	121.3	120.0	3.353	3.362	3.232	3.242
June	3.931	3.941	2.325	2.349	122.7	118.9	3.370	3.379	3.247	3.260
July	3.955	3.962	2.337	2.362	120.1	118.8	3.383	3.395	3.263	3.276
August	3.978	3.986	2.349	2.378	112.8	114.3	3.397	3.413	3.284	3.299
September	4.001	4.005	2.361	2.389	109.2	114.7	3.411	3.427	3.302	3.312

Fore. = August Forecast
C.E. = Current Expectations
* = This item and those beyond it are projections